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## Criminal probe begun into film tax incentives

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A criminal probe was opened Monday into the operations of the Iowa Film Office, which has become one of the state's largest business incentive programs.

The investigation was announced after the release of an accountant's review that showed existing tax credit contracts from the film office were changed — primarily to increase budgets — without notification of top officials at the Iowa Department of Economic Development. That department oversees the film office.

The report by the West Des Moines accounting firm Clifton Gunderson also found that signatures of top economic development officials were copied and moved from original contracts to revised ones; unidentified moviemakers claimed expenditures as high as \$650,000 that were wrongly approved; and moviemakers claimed a litany of other questionable expenses.

Former Iowa Film Office manager Tom Wheeler, who was hired in 2004 to do mostly marketing for what was then a tiny state program, was not blamed directly in the accounting firm's report. However, the review noted Wheeler had approved all tax credit applications, reviewed all expenditures, calculated qualifying expenses and issued tax credit certificates — all areas where serious problems were found.

Wheeler was fired last month.

Failure to perform duties required by law is a crime in Iowa. Those who exceed the authority of their office, make contracts "that contemplate expenditures ... known by the person to be in excess of that authorized by law" or who fail to report receipt or expenditures of public money are, at the very least, committing serious misdemeanors under existing statutes.

Knowingly making false records of any sort, such as documents, certificates or receipts, is a felony.

The attorney general's office said it is not permitted by ethics rules to discuss possible subjects of the criminal investigation. The statement said the office is working to recover "any tax credits or funds obtained illegally."

The future of the now-suspended tax credit program remained unclear Monday, as did the fate of 135 pending applications for film tax credits that are under review.

Officials in the governor's office and the Department of Economic Development declined to release details requested by reporters under the state's open-records law. Officials said "all documents related to this program, including emails, are being turned over to the investigators."

### No date specified for reinstating program

Gov. Chet Culver's office issued a statement Monday that provided no specific timeline for lifting the program's suspension. People who work in the film industry question continuing the freeze while the investigation is ongoing, saying the suspension is costing the state millions in economic activity.

Culver's statement read: "After reviewing this report, the film tax credit program should not move forward until interim director Hubbell and the Economic Development Board have received clear direction on the appropriate interpretation of the film program statute and the proper controls and oversight that must be followed."

Culver named Des Moines businessman Fred Hubbell to run the department until a replacement is hired.

Attorney General Tom Miller supported the suspension of the tax-credit program, saying past tax credits were not implemented according to state law or calculated properly.

A statement from Miller, who asked Iowa's Division of Criminal Investigation and the Polk County attorney's office to assist in the investigation, said that expenses were not adequately evaluated and verified and that projects were not justified in terms of their economic benefit to the state compared with their cost.

"Approximately \$32 million in tax credits have been issued, and we will review them in detail and seek recovery wherever they were obtained in violation of the law," Miller said.

Senate Majority Leader Michael Gronstal, D-Council Bluffs, said the report released Monday did not give the level of detail needed by lawmakers to determine the future of the tax credit program.

"If people did things that were illegal, then they should be prosecuted. That's pretty simple," Gronstal said. "That doesn't mean, by definition, that the program is bad. It might just mean that oversight was weak."

#### **Oversight, support for Wheeler faulted**

Many in the movie business expressed concern that Wheeler is being used as a scapegoat for a relatively new tax credit program, begun in 2007, that was not given appropriate oversight and manpower.

"You don't shut down a whole industry because of a couple bad actors," said Neil Wells, an actor and producer who has worked on three recent films in Iowa.

Wells said Culver has spoken frequently about protecting taxpayer money since he learned of possible abuses in mid-September.

"But he's actually taken about \$300 million away from Iowa's economy because filmmakers are starting to go elsewhere," Wells said.

Jon Hazell, a producer who has 12 potential projects pending but who has received no credits so far, said he was not surprised that the probe became a criminal one. However, he faulted state officials for not giving Wheeler more accountants and staff after the program began to quickly grow.

The accounting firm's review was initiated by former Department of Economic Development director Mike Tramontina, after he heard reports that two luxury vehicles had been purchased under the taxpayer-financed incentive program but not used in films.

Tramontina resigned at Culver's request on Sept. 18. His deputy, Vince Lintz, resigned the following week.

Until mid-September, the Iowa Film, Television and Video Project Promotion Program had been run by one man - Wheeler - who had little expertise in law or accounting. Since 2007, he oversaw 157 applications and related contracts for films projected to be worth as much as \$725.9 million to the state's economy.

#### **Revenue loss comes amid budget crunch**

The program's troubles bring with them significant budgetary and political implications: The film tax credit may cost the state millions more in revenue than anticipated during one of the worst budget years in Iowa history. Future revenue loss from pending applications for tax credits theoretically could reach as high as \$330.5 million. However, it's unlikely all projects will move forward.

Both Republicans and Democrats widely supported creation of the film tax credit. Only three legislators cast "no" votes.

State Auditor David Vaudt, a Republican, said Monday's report would serve as a starting point for the state's internal audit. Lack of proper record-keeping will most likely require state officials to seek records or additional information from filmmakers who were given the tax credits, he said.

"The key is if you have the right policies and procedures in place, and I think this is where this particular tax credit fell through," Vaudt said.

Sen. Jeff Danielson, D-Cedar Falls, the president pro tem of the Senate, said the findings show a widespread failure to appropriately oversee the program.

"There was a serious breach of trust in terms of managing the program, and the legislative branch has its responsibility right along with the executive branch," he said.

House Republican leader Kraig Paulsen of Hiawatha called the findings in Monday's report "outrageous." Still, he and other lawmakers said they were not ready to call for an end to the program.

Rep. Roger Thomas, D-Elkader, who is chairman of the House Economic Growth Committee, said he thought the majority of lawmakers would like to close any loopholes and continue with the incentive.

"We had such a positive thing going in the state and were creating a new industry," Thomas said.

#### **Main findings from accountants**

**INCOMPLETE RECORDS:** Film office files "were maintained in a disorganized fashion." Receipts and invoices were available for only two of 22 projects that had received tax credits.

**ALTERED CONTRACTS:** Contracts were apparently changed but not identified as revised. Mike Tramontina, former economic development director, and former deputy director Vince Lintz - who both resigned in the wake of the discoveries - did not appear to have been notified of the changes.

#### Advertisement

**BROKER FEES:** Brokers' fees that filmmakers and investors used to help them sell their tax credits were used to qualify for credits. In total, the report found that brokers' fees were used to qualify for more than \$250,000 in tax credits.

**PASS-THROUGH BUSINESSES:** In some cases, moviemakers used limited liability companies to purchase property and services from out-of-state businesses. The limited liability companies would then sell directly to the moviemaker in order to qualify for Iowa's tax credit. The accountants were unable to verify whether some Iowa-based businesses or limited liability companies being used to qualify for tax credits were registered with the state.

**UNQUALIFIED EXPENDITURES:** In some cases, expenses for out-of-state purchases were included as qualified Iowa expenditures, which are not permitted under the tax credit program. The report notes an example where one production had two \$1 million expenditures that qualified for more than 50 percent of the total qualifying expenditures for the production.

**ILLEGITIMATE LABOR:** Expenses for some labor were not eligible for Iowa's tax break but were approved anyway. In one film, the nonqualifying amounts exceeded \$650,000.

**DEFERRED PAYMENTS:** Iowa's law says that moviemakers may qualify for the tax breaks after they've spent the money. However, more than 100 expenses that were classified as "deferred" - some exceeding \$100,000 - were approved. The expenses were apparently not paid until after the state issued the tax credits.

**ADVERTISING IRREGULARITIES:** Companies were sometimes contracted by moviemakers to provide advertising for their production. In exchange, the company would receive advertising in the film or on merchandise related to the production. No cash was exchanged, but the amount was included as a qualified expense. In some cases, taxpayers subsidized multiple such transactions valued at more than \$1 million each.

**NONPRODUCTION EXPENSES:** It appears possible that some of the expenses used to qualify for taxpayer subsidies were not related to film production, including luxury vehicles, some exceeding \$50,000 each.

**NEPOTISM:** Family members or people with close connections appear to have benefited from some of the credits or relationships with moviemakers. The amounts varied, but some exceeded \$300,000.

**INACCURATE CALCULATION:** Iowa's tax break for films allows up to 25 percent for film investors and another 25 percent for filmmakers' costs. In at least six cases, some were given 50 percent credit based upon filmmakers' costs, while three others were given the entire amount based on investment credit. No projects, however, appear to have been issued certificates that exceeded 50 percent.

**ERRONEOUS AWARDS:** Some tax breaks were issued directly to the transferee, which is the business or person who purchased the tax credit at a reduced rate to help reduce his own income taxes. Such certificates are to be issued to the director, investor or producer.

#### How do tax credits work?

Tax credits are a tool governments use to spur the economy or help individuals. In Iowa, a production company filming a project can qualify for tax credits equal to up to 25 percent of what is spent here on the production. Additionally, investors in the film can qualify for credits of up to 25 percent of expenditures. The benefits to a film project can add up to 50 percent, prompting the state to advertise the incentives as "half-price filmmaking."

**APPLYING THE CREDITS:** Companies and individuals who qualify for film tax credits can apply them to reduce their own taxes owed in Iowa or sell them to other companies or individuals who want to lower their Iowa tax obligations. The credits help the production company and investors raise money for their film project.

**BUYING THE CREDITS:** Companies with a hefty Iowa tax bill are most likely to buy the credits - typically at a discount. For example, an insurance company could pay 80 cents for every \$1 of tax benefits it gets. So, an insurer could reduce its tax bill by \$500,000 by paying \$400,000 for the investor's and production company's tax credits.

**CLAIMING THE CREDITS:** State law says companies can claim film tax credits over five years. This year, the state capped the total amount of credits that can be awarded in a year at \$50 million.

#### What filmmakers are involved?

The makers of two movies - Bruce Isacson and Donald Borchers - are the only two moviemakers who have turned in complete receipts for their projects and the only two publicly accused so far of abusing the program.

**PURCHASES:** Isacson, who filmed the movie "South Dakota" last spring near Earlham, purchased a 2008 Range Rover for \$61,000 in March 2008, said Erin Seidler, spokeswoman for the economic development department. Borchers, a director known for horror films, remade the movie "Children of the Corn" last year. He purchased a 2008 Mercedes-Benz for his movie for \$67,783 in August 2008, Seidler said.

**ABUSING THE PROGRAM?** With both vehicles, claiming full purchase price was considered an abuse of the tax credit law, and state officials are seeking to recoup credits awarded as a result. State officials did not identify specific abuses by other tax credit recipients.

